

BENSON-MONTIN-GREER DRILLING CORP.

IBLA 89-457

Decided July 15, 1992

Appeal from a decision by the Deputy State Director, Mineral Resources, New Mexico State Office, Bureau of Land Management, affirming proposed assessments of compensatory royalty. NM SDR 89-17.

Reversed in part; vacated and remanded in part.

1. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

An operator who obtains a lease that is being drained by his offending well becomes a common lessee and is presumed to have knowledge of the drainage. This knowledge is presumed from the date that the party becomes the common lessee. Any duty to drill an offset well or pay compensatory royalty would arise a reasonable time thereafter.

2. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

Once BLM has established that a tract is being drained by a common lessee, the ultimate burden of proof that a protective well would be uneconomic rests with the common lessee. If the cost of drilling and operating an offset well, based on the conditions at the time this duty is acquired, is greater than the value of the recovered oil and gas, there is no breach of the lessee's duty to prevent drainage.

3. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

In order for BLM to assess an operator/lessee compensatory royalty for a period of time when the operator was a stranger to the lease, BLM must show, for example, that it had provided written notice operator/lessee's predecessor in interest and that the operator/lessee could be considered to have taken the subject to that notice or that it had been made a condition of Departmental approval of the assignment.

4. Administrative Authority: Generally--Appeals: Jurisdiction--Board of Land Appeals--Judicial Review--Oil and Gas Leases: Royalties: Generally

A statute establishing time limitations for commencement of judicial actions for damages on behalf of the States does not limit administrative proceedings within the Department of the Interior.

APPEARANCES: Michael G. Maloney, Esq., Austin, Texas, for appellant; Arthur Arguedas, Esq., Office of the Solicitor, Interior, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE BYRNES

Benson-Montin-Greer Drilling Corporation (BMG) has appealed from an April 13, 1989, decision by the Deputy Assistant Secretary for Land Resources, New Mexico State Office, Bureau of Land Management (BLM), affirming a determination by BLM's Albuquerque Office to deny BMG a compensatory royalty for drainage from certain Indian leases (Jicarilla Contracts (JC) 403, 404, and 408). JC 403 and 404 were assigned to BMG on September 12, 1968. JC 408 was effective on December 18, 1967. BMG became the lessee of record on JC 403 and 404 on September 12, 1968. BMG assigned these leases

from Tom Bolack. BMG became lessee of record on JC 408 on July 31, 1971 (Statement of Reasons (SOR) at 3). The royalty on leases is 16-2/3 percent.

According to the record, the offending well, D-21 Well No. 1, located on JC 200, began production on November 17, 1966, in the NW¼ of sec. 21, T. 27 N., R. 1 W., New Mexico Principal Meridian, Rio Arriba County, New Mexico, and its royalty is 16-2/3 percent. JC 403 embraces secs. 7, 8, 17, and 18. JC 404 embraces secs. 9, 10, 15, and 16. JC 408 embraces secs. 19, 20, and portions of secs. 21 and 22. Protective wells drilled on JC 403, 404, and 408 began production on January 17, 1978, December 29, 1977, and November 12, 1977, respectively.

On March 23 and 24, 1989, BLM's Albuquerque District Office issued individual letters advising BMG that each of the wells subject to drainage between the onset of production from the offending well (November 17, 1966) and the onset of production from the protective wells (November 12, December 29, 1977, and January 17, 1978), and that an economic protective well could have been drilled on or about November 17, 1966" and the date of onset of production from each of the protective wells, some 11 years later. ^{1/} BLM notified BMG that compensatory royalties would be based on a percentage of the offending well's production attributable to each of the drained leases.

^{1/} The record for JC 408 contains a letter dated June 17, 1980, from the District Oil and Gas Supervisor, Geological Survey, stating that JC 408 was subject to drainage from the No. 1 well in sec. 21 and that a protective well was necessary.

On March 28, 1989, BMG requested a technical and procedural review by the State Director. BMG alleged that the Office had failed to identify the date on which a commercial well could have been drilled in each instance, and it had not provided sufficient income to substantiate its determinations.

In his April 13, 1989, decision, the Deputy State Director stated in part:

BMG asserts that economic protective wells could not have been drilled prior to the time they were actually drilled. The BLM, however, determined that an economic well could have been drilled in 1968. A discounted cash flow analysis was performed by the BLM, using drilling and operating costs submitted by BMG, and actual production figures from the well. Taxes were estimated to be 25%. A rate of return of 8%, which is considered reasonable for the time period. Using these figures, a well drilled in 1968, the first year in which all three leases were effective, would have been profitable.^[2/]

The DM has correctly determined that drainage has occurred from lands covered by Jicarilla Contracts 403 and 408 and that an economic well could have been drilled on each lease in 1968.

As BMG correctly asserts, the March 23 and 24, 1989, letters by the Albuquerque District Office did not identify the date on which an economic protective well could have been drilled on each lease. Rather, they stated that such wells could have been drilled during the decade beginning on November 17, 1966, and ending between November 12, 1977, and January 17, 1978, depending on the lease.

Consequently, _____
^{2/} JC 408 was effective as of Dec. 18, 1967.

the Deputy State Director is inaccurate in attributing to the District Manager the conclusion that such wells could have been

BMG argues on appeal that BLM has failed to prove drainage occurred. In its SOR at page 22, BMG asserts that the only document offered to show drainage occurred during the proposed assessment period was a single document, a computer printout entitled "Drainage Data". BMG contends that BLM has failed to satisfy that burden. BLM asserts in its answer that the fact of drainage is well established in the record and that it never disputed that drainage was occurring until it filed its SOR.

BMG contends also that BLM's proposed assessment of compensatory royalty ignores the fact that BMG did not own the land until 1971 with respect to JC 408 and until 1977 with respect to JC 403 and 404. BMG argues that, having been a stranger to the land to those dates, it could have had no obligation to protect them from drainage. Additionally, BMG argues that it never received notice that drainage was occurring until after protective wells were drilled, that the offsetwells would not have been economic before that time, and that the attempt to assess compensatory royalty is barred by a statute of limitations.

We agree with BLM that the fact of drainage is well established. The file contains a number of geologic, engineering, and hydrologic compilations generated by BLM which leave little doubt that drainage occurred. BLM analyzed geology and reservoir characteristics again in 1988, to

determine if the reservoir under JC 403, 404, and 408 was the same quality as that under the offending well. BLM considered and well production data supplied by BMG. BLM found that production from the offending as well as the protective wells Puerto Chiquito Mancos Pool, and that all four wells "drilled to, tested, and produce from the same part of the El Vado member. In order to show continuity of the sand produced from the offending well to the protective wells, a well log correlation was log correlation and a net pay map it was determined that the interval produced from in the offending well is present throughout of the three leases. Additionally, BLM determined from water saturation and net pay maps that reservoir quality under the "is similar to that in the offending well." As a result of its study, BLM concluded that "the lower production rates of the production drainage of the offended portions of the subject leases during the 11-year interim period between producing dates of the protective wells" (Geology Report by R. W. Wilson dated Oct. 20, 1988).

Moreover, throughout its correspondence with BLM preceding this appeal, BMG never disputed that drainage was occurring. In a July 2, 1980, letter responding to notice that drainage was occurring, BMG stated that "wells completed on all leases produced of supply, a low quality reservoir in the Niobrara member of the Mancos formation." 3/

3/ BMG's July 2, 1980, letter has not been included in the file. The quote is from BLM's Jan. 5, 1984, letter which again noted from

The file on JC 408 contains a portion of an attachment BMG submitted with its July 2, 1980, letter. ^{4/} Therein, BMG advised that it had already been drilled on JC 408 and that it was producing, and argued that because of well-spacing and the principle of "no royalties were lost to the Jicarilla lease holders.

By letter of September 17, 1984, BLM notified BMG that JC 403 and 404 were also subject to drainage by the Jicarilla No. 1 during the period 1966-77. BLM requested BMG to submit engineering or geologic data indicating that drainage did not occur. occurred.

In an October 4, 1984, letter to BLM, BMG argued, based on Nola Grace Ptasynski, 63 IBLA 240, 89 I.D. 208 (1984), that, as to adjacent leases, it was not liable for compensatory royalty until a reasonable period after it first received notice that drainage was occurring. With respect to JC 403 and 404, BMG contended that any obligation to pay compensatory royalties did not arise until after September 19, 1984, the date on which it first received notice of

fn. 3 (continued)

JC 408 and of BLM's position that compensatory royalties were owing from 1966 to 1977, when the protective well on JC 408 was drilled. ^{4/} The portion, consisting of one page, is captioned:

"ATTACHMENT NO.II TO LETTER OF JULY 2, 1980, TO U.S.G.S. RE JICARILLA LEASE CONTRACTS"

"While the case file for JC 408 contains a June 17, 1980, letter from U.S.G.S. informing BMG of drainage from JC 408, the July 2, 1980, letter apparently was in response to more than one letter, since the attachment states '[r]esponse to each situation described in your letters follows * * *.'"

Only one of those "situations" is involved in this case, drainage from JC 408.

drainage from those two leases. In ensuing correspondence, BMG and BLM debated the issue of whether economic protection was required for the wells drilled earlier than they were drilled. However, the record contains no geologic data submitted by BMG challenging the fact of drainage.

Even on appeal, BMG does not offer any geologic data to refute BLM's conclusion that drainage occurred on the leased acreage. BMG's argument is, not that drainage did not occur but that BLM failed to prove that it did. We disagree. As our discussion makes clear, overwhelmingly, the record establishes the fact of drainage.

[1] BMG concedes the fact that it became the common lessee of JC 403 and 404 on September 9, 1977, and JC 405 on September 9, 1977. The Board has held that in a common lessee/operator situation, the lessee who drills the offending well is in the best position to know whether drainage is occurring, and that the common lessee/operator will be presumed to have knowledge of drainage from the time of first production of the well. Petroleum, Inc., 115 IBLA 188, 191-92 (1990); NGC Energy Co., 114 IBLA 141, 152, 97 I.D. 159, 165 (1990); Atlantic Richfield Co. Reconsideration, 110 IBLA 200, 96 I.D. 363 (1989); Atlantic Richfield Co., 105 IBLA 218, 226, 95 I.D. 235, 240 (1988). In this case, common ownership or control situation existed at the time the offending well was drilled. Thus, the presumption of knowledge of drainage at the time of production is logical. In this case, common ownership did not develop until a number of years following the drilling of the offending well. BMG had no right or obligation to drill an offset well until it acquired the drained acreage. BMG

must be presumed to have had knowledge of drainage from JC 403, 404, and 408 when it acquired those leases.

The knowledge of drainage does not alone create an obligation to pay compensatory royalty. That obligation arises only after a reasonable time following the date of the lessee's knowledge. CSX Oil & Gas Corp., 104 IBLA 188, 198, 95 I.D. 148, 151; Ptasynski, 63 IBLA at 253, 89 I.D. at 215. This is so because a lessee may relieve itself of the obligation to pay compensatory royalty by drilling an offset well, and it has a reasonable time after notice or knowledge of drainage to do so. If an offset well can be drilled, and a reasonable time no well has been drilled, compensatory royalty becomes a continuing obligation until completion of the offset well.

In this case, BMG is presumed to have knowledge of drainage from JC 403 on September 9, 1977, the date of lease acquisition. BMG completed a well on JC 403 on January 17, 1978, just over 4 months later. We expressly find that BMG acted within a reasonable time after knowledge of drainage to drill an offset well on JC 403. Therefore, BMG is not responsible for the payment of compensatory royalty from JC 403. It follows that no compensatory royalty is due for drainage from JC 404 either, since that lease was acquired before the offset well was completed by BMG thereon even more quickly, on December 29, 1977, a period of less than 4 months from acquisition. We hereby reverse BLM's decision as it applies to these two leases for this period of time.

[2] The only lease for which BMG may be responsible for compensatory royalty is JC 408. BMG acquired the lease on July 31, 1971. It did not complete an offset well thereon until over 6 years later. Accordingly, the obligation to pay compensatory royalty began at a reasonable time after July 31, 1971, and continued until the completion of the well on JC 408. However, since BLM's determination that a prudent operator would have drilled a well on JC 408 was based on its production calculations from 1966 until 1977, it must reexamine its conclusion that the critical time period should have been from a reasonable time after July 31, 1971, until BMG drilled the well. The cost and production figures utilized should be those existing at a reasonable time after July 31, 1971. CSX Oil & Gas Corp. v. BLM, 95 I.D. at 154 n.11.

Thus, we must vacate BLM's decision regarding JC 408 and remand the case to allow BLM to make a prudent operator determination based on the dates set forth herein. As in Atlantic Richfield Co., 105 IBLA at 229, 95 I.D. at 242, BLM should decide what was a reasonable time after acquisition of JC 408 for completion of an offset well. If BLM concludes that a prudent operator would have drilled a well, it should determine the amount owed as compensatory royalty and inform BMG of its preliminary findings. If BMG believes that a prudent operator would not drill a well, it should submit all pertinent data supporting its position to BLM. BMG bears the ultimate burden of proof on this issue.

^{5/} In no event can BMG's obligation to pay compensatory royalties be for a time greater than that particular period.

make its final determination of whether compensatory royalties are due for JC 408.

Based on the present case records, BMG would not owe compensatory royalty for any of the leases for any period of time

following acquisition of the leases. In CSX Oil & Gas Corp., 104 IBLA at 199, 95 I.D. at 154, we held that where BLM shows compensatory royalty for any period of time prior to providing formal notice of drainage, it has the burden of proving that a lessee knew or a reasonably prudent operator would have known of drainage. However, in this case even assuming that BLM could establish that BMG knew or a reasonably prudent operator would have known prior to the dates BMG obtained the three leases, BMG is not responsible for compensatory royalty. The reason is simple. BMG was not the lessee or operator of the leases during those periods of time. Thus, it is clear that if BMG had been the lessee or operator of JC 403, 404, and 408, it could not have been in a compensatory royalty situation with regard to any of those leases.

[3] A notice of drainage issued by BLM typically informs the recipient that drainage is occurring on certain described lands and that some action to protect those lands by drilling a well is necessary, unless it can be shown that no drainage is occurring or that a protective well is not necessary to drill a well; and that in the absence of such a showing compensatory royalty will be assessed. See, e.g. Chevron U.S.A. Inc., 104 IBLA at 351, 95 I.D. at 154. If BMG had been in control of the drained acreage, however, it would be impossible to drill a protective well. As a stranger to the leases until the notice of drainage was issued, BMG was not in a position to

BMG could not have drilled a well prior to acquisition to curb drainage. Since compensatory royalty is designed to compensate for damage occurring because of a failure to complete a protective well, there is no rationale for requiring BMG, as a stranger to the lease, to pay compensatory royalty for a period of time during which it could have had no obligation to drill, unless BLM, for example, could show that a predecessor in interest was liable for payment of compensatory royalties, and that BMG knew of this liability and accepted the assignment, or that acceptance of the liability was a specific condition of Departmental approval of the assignment. There is no evidence of acceptance or imposition of liability in this case. 6/

[4] We reject BMG's assertion that the statute of limitations contained in 28 U.S.C. § 2415 (1988) bars BLM from denying BMG access to access compensatory royalties. This Board has previously held statutes of limitations may apply to judicial enforcement of BLM decisions but not to the underlying administrative actions. See Anadarko Petroleum Corp., 122 IBLA 141, 147 (1992); Marathon Oil Co., 122 IBLA 141, 147 (1992); Mobil Exploration & Producing U.S., Inc., 119 IBLA 76, 81, 98 I.D. 207, 210 (1991).

Our disposition of this case makes it unnecessary to rule on BLM's motion for a hearing in this matter.

6/ In CSX, 104 IBLA at 199, 95 I.D. at 154, we vacated and remanded a BLM decision assessing compensatory royalties and a subsequent decision assessing compensatory royalties against a person for a period when that person was a stranger to the lease on the basis for doing so.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 4
appealed from is reversed, in part, and vacated and the case remanded, in part, to BLM.

James L. Byrnes
Administrative Judge

I concur:

Bruce R. Harris
Deputy Chief Administrative Judge